

1991

Proposed statement on auditing standards : the meaning of "Present fairly in conformity with generally accepted accounting principles" in the independent auditor's report; Meaning of "Present fairly in conformity with generally accepted accounting principles" in the independent auditor's report; Exposure draft (American Institute of Certified Public Accountants), 1991, May 31

American Institute of Certified Public Accountants. Auditing Standards Board

Follow this and additional works at: [https://egrove.olemiss.edu/aicpa\\_sop](https://egrove.olemiss.edu/aicpa_sop)

Part of the [Accounting Commons](#), and the [Taxation Commons](#)

### Recommended Citation

American Institute of Certified Public Accountants. Auditing Standards Board, "Proposed statement on auditing standards : the meaning of "Present fairly in conformity with generally accepted accounting principles" in the independent auditor's report; Meaning of "Present fairly in conformity with generally accepted accounting principles" in the independent auditor's report; Exposure draft (American Institute of Certified Public Accountants), 1991, May 31" (1991). *Statements of Position*. 552.  
[https://egrove.olemiss.edu/aicpa\\_sop/552](https://egrove.olemiss.edu/aicpa_sop/552)

# **EXPOSURE DRAFT**

## **PROPOSED STATEMENT ON AUDITING STANDARDS**

### **THE MEANING OF *PRESENT FAIRLY IN CONFORMITY WITH GENERALLY ACCEPTED ACCOUNTING PRINCIPLES* IN THE INDEPENDENT AUDITOR'S REPORT**

**MAY 31, 1991**

**Prepared by the AICPA Auditing Standards Board  
For comment from persons interested in auditing and reporting**

**Comments should be received by August 1, 1991, and addressed to  
Douglas P. Sauter, Technical Manager, AICPA Auditing Standards Division, File 2701  
AICPA, 1211 Avenue of the Americas, New York, N.Y. 10036-8775**

## SUMMARY

### **Why Issued**

The Financial Accounting Foundation (FAF) has oversight responsibilities for the Financial Accounting Standards Board (FASB) and the Governmental Accounting Standards Board (GASB). In late 1989, the FAF determined that “an entity subject to the jurisdiction of one board should not be required to change its reporting principles as a result of a standard issued by the other board.” In making this determination, the FAF recognized that the existing hierarchy of generally accepted accounting principles (GAAP) contained in AICPA Professional Standards, volume 1, AU section 411, “The Meaning of ‘Present Fairly in Conformity With Generally Accepted Accounting Principles’ in the Independent Auditor’s Report,” would need to be revised. The Auditing Standards Board (ASB) formed a task force to reconsider the existing GAAP hierarchy. That task force included representatives of the Accounting Standards Executive Committee (AcSEC, the AICPA’s senior technical committee on financial accounting and reporting standards), the FASB, the GASB, and the ASB.

In addition to revising the hierarchy so that the FASB and the GASB would each have primary responsibility for setting standards for those reporting entities subject to the jurisdiction of that board, the task force evaluated whether certain sources of GAAP were classified in the appropriate category and whether each category should have a separate level of authority. The task force developed the guidance described in this exposure draft, which would revise the existing hierarchy described in AU section 411, the sources for which are Statement on Auditing Standards (SAS) Nos. 5, 43, and 52.

### **What It Does**

This proposed Statement would —

- Establish two separate but parallel hierarchies: one for state and local governmental entities and one for nongovernmental entities (see the summary chart immediately following this summary).
- Distinguish between AcSEC documents that have been cleared by either the FASB or the GASB and those documents that have not been cleared. AcSEC’s operating policies permit the committee to issue accounting guidance over the objection of the FASB or GASB. The proposed Statement notes that the word *cleared* means that the rule 203 body — the FASB or the GASB — has not objected to the issuance of a proposed pronouncement.
- Establish a separate category for cleared AICPA AcSEC Practice Bulletins and Emerging Issues Task Force consensus positions (category (c) of the proposed hierarchy).
- Make each successive category in the hierarchy a different level of authority. (Categories (b) and (c) of the existing hierarchy, both sources of established accounting principles, are considered to be equal in authority.) As shown in the summary chart, this change would elevate the authority of certain accounting pronouncements, such as AICPA AcSEC Statements of Position, Audit and Accounting Guides, and Practice Bulletins that have been cleared, as well as Emerging Issues Task Force consensus, that are effective after the effective date of this proposed Statement above the authority of widely recognized and prevalent industry accounting practices.

The intent of this proposed Statement is for the revised levels of authority of the respective categories to apply prospectively. Thus, although the issuance of this proposed Statement would not in itself trigger accounting changes, accounting pronouncements in categories (b) and (c) of paragraphs .08 and .10 that are effective after the effective date of this proposed Statement might require accounting changes since they would be of greater authority than widely recognized and prevalent industry accounting practices. Thus, for example, a non-state-and-local-governmental entity that follows a widely recognized and prevalent industry practice would need to change to an accounting treatment specified by a cleared AICPA Statement of Position, a cleared AICPA Industry Audit and Accounting Guide, a cleared AcSEC Practice Bulletin, or a consensus position of the FASB Emerging Issues Task Force whose effective dates are after the effective date of the proposed Statement.

### **How It Affects Existing Standards**

This proposed Statement would replace paragraphs .05 through .11 of AU section 411 (AICPA, *Professional Standards*, vol. 1). Those paragraphs set forth the existing hierarchy, which is presented in the summary chart immediately following this summary.

---

*This exposure draft has been sent to—*

- *Practice offices of CPA firms.*
  - *Members of AICPA Council and technical committees.*
  - *State society and chapter presidents, directors, and committee chairpersons.*
  - *Organizations concerned with regulatory, supervisory, or other public disclosure of financial activities.*
  - *Persons who have requested copies.*
-

## GAAP HIERARCHY SUMMARY

<u>Nongovernment Entities</u>	<u>Proposed Revisions</u>	<u>State and Local Governments</u>	<u>Existing Hierarchy</u>
<p>a. FASB Statements and interpretations, APB Opinions, and AICPA Accounting Research Bulletins</p>	<p>a. CASB Statements and interpretations, plus AICPA and FASB pronouncements if made applicable to state and local governments by a CASB Statement or interpretation</p>	<p>a. FASB Statements and interpretations, APB Opinions, AICPA Accounting Research Bulletins, and, for state and local governments, GASB Statements and interpretations</p>	
<p>b. FASB Technical Bulletins, cleared AICPA Industry Audit and Accounting Guides, and cleared AICPA Statements of Position</p>	<p>b. CASB Technical Bulletins, and the following pronouncements if specifically made applicable to state and local governments by the AICPA: cleared AICPA Industry Audit and Accounting Guides and cleared AICPA Statements of Position</p>		
<p>c. Consensus positions of the FASB Emerging Issues Task Force and cleared AcSEC Practice Bulletins</p>	<p>c. Consensus positions of the GASB Emerging Issues Task Force and cleared AcSEC Practice Bulletins if specifically made applicable to state and local governments by the AICPA</p>		
<p>d. AICPA accounting interpretations, "Qs and As" published by the FASB staff, uncles AICPA Industry Audit and Accounting Guides, and uncles AICPA Statements of Position, as well as industry practices widely recognized and prevalent</p>	<p>d. "Qs and As" published by the GASB staff, uncles AICPA Statements of Position and uncles Industry Audit and Accounting Guides specifically made applicable to state and local governments by the AICPA, as well as industry practices widely recognized and prevalent</p>	<p>b. AICPA Industry Audit and Accounting Guides, AICPA Statements of Position, and Technical Bulletins issued by the FASB or the GASB</p>	<p>c. AICPA accounting interpretations, as well as practices that are widely recognized and prevalent in the industry</p>
<p>e. Other accounting literature, including FASB Concepts Statements, APB Statements, AICPA Issues Papers, International Accounting Standards Committee Statements, GASB Statements, interpretations and technical bulletins, pronouncements of other professional associations or regulatory agencies, AICPA <i>Technical Practice Aids</i>, and accounting textbooks, handbooks, and articles</p>	<p>e. Other accounting literature, including GASB Concepts Statements, pronouncements in categories (a) through (d) of the hierarchy for non-governmental entities when not specifically made applicable to state and local governments, APB Statements, FASB Concepts Statements, AICPA Issues Papers, International Accounting Standards Committee Statements, pronouncements of other professional associations or regulatory agencies, AICPA <i>Technical Practice Aids</i>, and accounting textbooks, handbooks, and articles</p>	<p>d. Other accounting literature, including APB Statements, AICPA Issues Papers, AcSEC Practice Bulletins, minutes of the FASB Emerging Issues Task Force, Concepts Statements issued by the FASB or the GASB, International Accounting Standards Committee Statements, pronouncements of other professional associations or regulatory agencies, and accounting textbooks and articles</p>	

May 31, 1991

Accompanying this letter is an exposure draft, approved by the Auditing Standards Board, of a proposed statement on auditing standards titled The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles in the Independent Auditor's Report. This proposed Statement would supersede paragraphs .05 through .11 of AICPA Professional Standards, volume 1, AU section 411, to provide revised guidance to the auditor about the hierarchy of generally accepted accounting principles. A summary of the proposed Statement also accompanies this letter.

Comments or suggestions on the proposed revisions to AU section 411 as described in this exposure draft will be appreciated. To facilitate consideration of responses by the Auditing Standards Board, comments should refer to specific paragraphs and include supporting reasons for each suggestion or comment.

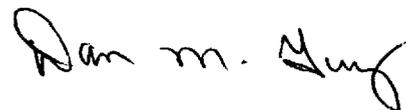
In developing guidance, the Auditing Standards Board considers the relationship between the cost imposed and the benefits reasonably expected to be derived from audits. It also considers the differences that the auditor may encounter in the audit of the financial statements of small businesses and, when appropriate, makes special provisions to meet those needs. Thus, the Board would particularly appreciate comments on those matters.

Written comments on the exposure draft will become part of the public record of the AICPA Auditing Standards Division and will be available for public inspection at the offices of the AICPA after September 1, 1991, for one year. Responses should be sent to the Auditing Standards Division, File 2701, in time to be received by August 1, 1991.

Sincerely,



Donald L. Neebes  
Chairman  
Auditing Standards Board



Dan M. Guy  
Vice President  
Auditing Standards Division

## PROPOSED STATEMENT ON AUDITING STANDARDS

### THE MEANING OF PRESENT FAIRLY IN CONFORMITY WITH GENERALLY ACCEPTED ACCOUNTING PRINCIPLES IN THE INDEPENDENT AUDITOR'S REPORT

The following paragraphs replace paragraphs .05 through .11 of AU section 411, "The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles in the Independent Auditor's Report" (AICPA, *Professional Standards*, vol. 1). The sources for AU section 411 are *Statement on Auditing Standards (SAS)* Nos. 5, 43, and 52.

.05 Independent auditors agree on the existence of a body of generally accepted accounting principles, and they are experts in these principles and in the determination of their general acceptance. Nevertheless, the determination that a particular accounting principle is generally accepted may be difficult because no single reference source exists for all such principles. The sources of established accounting principles that are generally accepted in the United States are—

a. Accounting principles promulgated by a body designated by the AICPA Council to establish such principles, pursuant to rule 203 (AICPA, *Professional Standards*, vol. 2, ET sec. 203.01) of the AICPA Code of Professional Conduct. Rule 203 provides that an auditor should not express an unqualified opinion if the financial statements contain a material departure from such pronouncements unless, because of unusual circumstances, adherence to the pronouncements would make the statements misleading. Rule 203 implies that application of officially established accounting principles almost always results in the fair presentation of financial position, results of operations, and cash flows, in conformity with generally accepted accounting principles. Nevertheless, rule 203 provides for the possibility that literal application of such a pronouncement might, in unusual circumstances, result in misleading financial statements. (See paragraphs 14 and 15 of SAS No. 58,

*Reports on Audited Financial Statements* [AICPA, *Professional Standards*, vol. 1, AU sec. 508].)

- b. Pronouncements of bodies, composed of expert accountants, that deliberate accounting issues in public forums for the purpose of establishing accounting principles or describing existing practices that are generally accepted, provided those pronouncements have been exposed for public comment and have been cleared by a body referred to in category (a).<sup>1</sup>
- c. Pronouncements of bodies, organized by a body referred to in category (a) and composed of expert accountants, that deliberate accounting issues in public forums for the purpose of interpreting or establishing accounting principles or describing existing accounting practices that are generally accepted, or pronouncements referred to in category (b) that have been cleared by a body referred to in category (a) but that have not been broadly distributed for public comment.
- d. Practices or pronouncements that are widely recognized as being generally accepted because they represent prevalent practice in a particular industry, or the knowledgeable application to specific circumstances of pronouncements that are generally accepted or pronouncements referred to in categories (b) and (c) that have not been cleared by a body referred to in category (a).

<sup>1</sup>For purposes of this Statement, the word *cleared* means that the body referred to in category (a) has indicated that it does not object to the issuance of a proposed pronouncement. Although implementation details have not been resolved as of the date of this exposure draft, in the event that any of the pronouncements described in categories (b) and (c) issued by the AICPA are not cleared, the AICPA plans to highlight that fact in the uncleared pronouncement to clarify the uncleared pronouncement's level of authority in the hierarchy.

.06 Generally accepted accounting principles recognize the importance of recording transactions in accordance with their substance. The auditor should consider whether the substance of transactions differs materially from their form. If the accounting treatment of a transaction or event is not specified by a pronouncement covered by rule 203, the auditor should consider whether the accounting treatment is specified by another source of established accounting principles.

.07 Categories (b), (c), and (d) are all sources of established accounting principles. If an established accounting principle from one or more sources in categories (b), (c), or (d) is relevant to the circumstances, the auditor should be prepared to justify a conclusion that another treatment is generally accepted. If there is a conflict between accounting principles relevant to the circumstances from one or more sources in categories (b), (c), or (d), the auditor should follow the treatment specified by the source in the higher category—for example, category (b) treatment over category (c)—or be prepared to justify a conclusion that a treatment specified by a source in the lower category better presents the substance of the transaction in the circumstances. The auditor should be aware that the accounting requirements adopted by regulatory agencies for reports filed with them may differ from generally accepted accounting principles in certain respects. Paragraph .04 of AU section 544, "Lack of Conformity With Generally Accepted Accounting Principles" (AICPA, *Professional Standards*, vol. 1) and SAS No. 62, *Special Reports* (AICPA, *Professional Standards*, vol. 1, AU sec. 623), provide guidance if the auditor is reporting on financial statements prepared in conformity with a comprehensive basis of accounting other than generally accepted accounting principles.

## EXPOSURE DRAFT

.08 For financial statements of entities other than governmental entities—<sup>2</sup>

- a. Category (a), officially established accounting principles, consists of Financial Accounting Standards Board (FASB) Statements of Financial Accounting Standards, FASB interpretations, Accounting Principles Board (APB) Opinions, and AICPA Accounting Research Bulletins.
- b. Category (b) includes FASB Technical Bulletins and, if cleared by the FASB, AICPA Industry Audit and Accounting Guides and AICPA Statements of Position.
- c. Category (c) includes AICPA Accounting Standards Executive Committee (AcSEC) Practice Bulletins that have been cleared by the FASB and consensus positions of the FASB Emerging Issues Task Force.<sup>3</sup>
- d. Category (d) includes AICPA accounting interpretations, implementation guides (“Qs and As”) published by the FASB staff, and practices that are widely recognized and prevalent either generally or in the industry. Category (d) also includes AICPA pronouncements referred to in categories (b) and (c) that have not been cleared by the FASB.

.09 In the absence of a pronouncement covered by rule 203 or by another source of established accounting principles, the auditor of financial statements of entities other than governmental entities may consider other accounting literature, depending on its relevance in the

<sup>2</sup>Rules and interpretive releases of the Securities and Exchange Commission (SEC) have an authority similar to category (a) pronouncements for SEC registrants. In addition, the SEC staff issues Staff Accounting Bulletins that represent practices followed by the staff in administering SEC disclosure requirements.

<sup>3</sup>The SEC’s Chief Accountant has stated that registrants would be expected to follow the positions agreed to under a consensus of the FASB Emerging Issues Task Force because the consensus position represents the best thinking on areas for which there are no specific standards. Those registrants who do not follow these positions will be asked to justify departures from any consensus reached.

circumstances. Other accounting literature includes, for example, FASB Statements of Financial Accounting Concepts; APB Statements; AICPA Issues Papers; International Accounting Standards of the International Accounting Standards Committee; Governmental Accounting Standards Board (GASB) Statements, interpretations, and Technical Bulletins; pronouncements of other professional associations or regulatory agencies; AICPA Technical Practice Aids; and accounting textbooks, handbooks, and articles. The appropriateness of other accounting literature as a source of established accounting principles depends on its relevance to particular circumstances, the specificity of the guidance, and the general recognition of the issuer or author as an authority. For example, FASB Statements of Financial Accounting Concepts would normally be more influential than other sources in this category.

.10 For financial statements of state and local governmental entities—<sup>4</sup>

- a. Category (a), officially established accounting principles, consists of GASB Statements and interpretations. Category (a) also includes AICPA and FASB pronouncements if specifically made applicable to state and local governmental entities by GASB Statements or interpretations. GASB Statements and interpretations are periodically incorporated in the *Codification of Governmental Accounting and Financial Reporting Standards*.
- b. Category (b) includes GASB Technical Bulletins and, if specifically made applicable to state and local governmental entities by the AICPA and cleared by the GASB, AICPA Industry Audit and Accounting Guides and AICPA Statements of Position.
- c. Category (c) includes AICPA AcSEC Practice Bulletins that have been cleared by the GASB if

<sup>4</sup>State and local governmental entities include public benefit corporations and authorities, public employee retirement systems, and governmental utilities, hospitals, colleges, and universities.

specifically made applicable to state and local governmental entities, as well as consensus positions of a group of accountants organized by the GASB, similar to the FASB’s Emerging Issues Task Force, that attempts to reach consensus positions on accounting issues applicable to state and local governmental entities.<sup>5</sup>

- d. Category (d) includes implementation guides (“Qs and As”) published by the GASB staff, as well as practices that are widely recognized and prevalent in state and local government. Category (d) also includes AICPA pronouncements referred to in categories (b) and (c) that have not been cleared by the GASB.

.11 In the absence of a pronouncement covered by rule 203 or by another source of established accounting principles, the auditor of financial statements of state and local governmental entities may consider other accounting literature, depending on its relevance in the circumstances. Other accounting literature includes, for example, GASB Concepts Statements; the pronouncements referred to in categories (a) through (d) of paragraph .08 when not specifically made applicable to state and local governmental entities either by the GASB or by the organization issuing them; APB Statements; FASB Concepts Statements; AICPA Issues Papers; International Accounting Standards of the International Accounting Standards Committee; pronouncements of other professional associations or regulatory agencies; AICPA Technical Practice Aids; and accounting textbooks, handbooks, and articles. The appropriateness of other accounting literature as a source of established accounting principles depends on its relevance to particular circumstances, the specificity of the guidance, and the general recognition of the issuer or author as an authority. For example, GASB Concepts Statements would normally be more influential than other sources in this category.

<sup>5</sup>As of the date of this proposed Statement, the GASB had not organized such a group.

## EXPOSURE DRAFT

.12 Because of developments such as new legislation or the evolution of a new type of business transaction, there sometimes are no established accounting principles for recording and presenting a specific event or transaction. In those instances, it might be possible to account for the event or transaction on the basis of its substance by selecting an accounting principle that appears appropriate when applied in a manner similar to the application of an established principle to an analogous event or transaction.

### **APPLICABILITY OF HIERARCHY**

.13 Most of the practices or pronouncements in categories (b),

(c), and (d) of paragraphs .08 and .10 had equal authoritative standing before the issuance of this Statement. An entity following an accounting treatment in category (c) or (d) as of the effective date of this Statement need not change to an accounting treatment in a category-(b) or category-(c) pronouncement whose effective date is before the effective date of this Statement. For example, a non-governmental entity that followed a prevalent industry practice (category (d)) as of the effective date of this Statement need not change to an accounting treatment included in a pronouncement in category (b) or (c) (for example, an accounting principle in a cleared AICPA Statement of Position or AcSEC Practice Bulletin)

whose effective date is before the effective date of this Statement. For pronouncements whose effective date is subsequent to the effective date of this Statement, the auditor should follow the applicable hierarchy established by paragraphs .08 and .10 in determining whether an entity's financial statements are fairly presented in conformity with generally accepted accounting principles.

### **EFFECTIVE DATE**

.14 This Statement is effective for audits of financial statements for periods ending after December 15, 1991.